UCITS

Thornburg Strategic Income Fund

Portfolio Manager Commentary
31 December 2023

Market Review

Interest rates began the fourth quarter on the same upward march that characterized the previous few months, with the 10-year Treasury in mid and late October briefly eclipsing 5%, the highest level in over 15 years. This set the stage for a meaningful reversal, with rates rallying significantly into year-end. The broad measure of the U.S. bond market, the Bloomberg U.S. Aggregate Index, generated the highest single quarterly total return since the 2nd quarter of 1989. The interest rate rally was powered by further optimism on falling inflation, with headline CPI falling to 3.1% in December from 3.7% two months prior. Most significantly, the output from the Federal Reserve's December meeting was judged by markets to be unexpectedly dovish, with the FOMC projecting three cuts in 2024 instead of the previous forecast of two. In response, risk assets rallied strongly into the year-end, with spreads across many sub-markets moving tighter for the quarter.

Attractive yields provide an offset to tight spreads given current macro uncertainties.

Fourth Quarter 2023 Performance Highlights

- In 4Q23 the portfolio (I Acc share class) returned 4.81%, -2.0 basis points behind the Bloomberg U.S. Universal Index. Year to date the portfolio (I Acc share class) returned 8.19%, 2.0 basis points ahead of the Bloomberg U.S. Universal Index.
- The portfolio's structural short duration position versus the index was the primary detractor in an environment where interest rates fell rapidly on inflation optimism and Fed dovishness. Nonetheless, positive duration contributed from a total return perspective. The portfolio held an average duration of 3.5 years for the fourth quarter.
- Exposure to both investment-grade and high-yield corporates was beneficial, as credit outperformed in sympathy with the broader risk rally. However, our up-in-quality bias detracted as lower-rated sectors did better than their higher-rated counterparts.
- Our allocation to asset-backed securities (ABS) proved to be a modest detractor, as the sector lagged other spread sectors during the quarter.
- Exposure to low-coupon MBS pass-throughs, which serve as a high-quality hedge to the portfolio's credit exposure, was also a modest detractor. Although the positions performed well on a total return basis, our modest position and underweight to the benchmark hindered the positions from generating relative outperformance.

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Supported by the entire Thornburg investment team

AVERAGE ANNUAL TOTAL RETURNS (%) AS OF 31 DECEMBER 2023	QTR	YTD	1-YR	3-YR	5-YR	ITD (28 DEC 18)
Class A Acc Shares	4.62	7.30	7.30	-0.21	2.51	2.51
Class I Acc Shares	4.81	8.19	8.19	0.57	3.30	3.29
Bloomberg U.S. Universal Index	6.83	6.17	6.17	-2.97	1.44	1.48
Blended Index	7.74	9.04	9.04	-1.15	3.56	3.62

CALENDAR YEAR RETURNS (%)	2023	2022	2021	2020	2019
Class A Acc Shares	7.30	-8.58	1.32	6.85	6.60
Class I Acc Shares	8.19	-7.96	2.16	7.64	7.40
Bloomberg U.S. Universal Index	6.17	-12.99	-1.10	7.58	9.29
Blended Index	9.04	-13.87	2.85	9.68	12.45

Performance data shown represents past performance and is no guarantee of future results. Investment return and principal value will fluctuate so shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than quoted.

For performance current to the most recent month end, visit http://www.thornburg.com/ucits.

Source: Confluence
In US$ terms. **Returns may increase or decrease as a result of currency fluctuations.**
Returns for less than one year are not annualized. ITD is inception to date.
Share classes are accumulating and denominated in USD. See prospectus for additional share class listings.
The Blended Index is composed of 80% Bloomberg U.S. Aggregate Bond Index and 20% MSCI World Index.

Current Positioning and Outlook

Markets entered calendar year 2024 grappling with two significant macro uncertainties. One is, to what extent the Federal Reserve pivots its policy and delivers on rate cuts. Second is whether the economy can successfully navigate a soft landing, or if recession still looms. Markets reacted with surprise at the Fed's dovish pause in mid-December, and there is little doubt the tone has shifted in a way that suggests a reasonable pivot ahead. However, we believe the Fed will be reluctant to cut rates in a significant way because of the still arduous task to lower core inflation back to the 2% target. While energy, goods, and even food inflation has moderated, services inflation remains resilient and is now by far the dominant driver of the CPI print.

What does this mean for the Fed? For one, services inflation is most closely aligned with wage inflation, and indeed we have seen upward wage pressures given the still tight U.S. employment market, and notable wage increases secured in the last year by unionized workers. The Powell Fed has been explicit in stating their desire to see wage gains be broad based socioeconomically, and for this reason the FOMC may very well be willing to tolerate inflation above 2% given that so much of the current CPI contribution is driven by services. With the Fed Funds upper bound at 5.5%, a full three percentage points above their median long-term projection, the Fed appears to have the flexibility to deliver cuts to navigate a soft landing while keeping rates in restrictive enough territory to keep the inflation push downward.

Regarding the second major uncertainty – recession or no recession – the headline data, in the form of real GDP and non-farm payrolls, make the persuasive case for a soft landing. We broadly disagree with this assessment. The underlying trends in the economy we believe are weaker than the headlines appear. Although the consumer by and large is still employed, credit card delinquencies nonetheless continue to rise across all age groups. The corporate balance sheet is pressured by still elevated rates, falling interest coverage ratios, and rising bankruptcies. Data shows that bank lending has tightened to levels last seen during COVID, and before that, the global financial crisis. These macro risks give us enough caution to position the portfolio defensively as these conditions play out.

We have decreased our portfolio duration very modestly, to 3.5 years as of early January, versus 3.7 years at the beginning of October, as rates have come down from their fall peak. The continued prospect for a pivot, and the potentially growth-challenged 2024, keep duration risk attractive versus credit risk. We plan to stay patient in reducing duration even if rates resume a downward trajectory. Meanwhile, agency mortgage-backed securities (MBS) have compelling relative value versus high grade credit. Low coupon pass-throughs in particular have attractive dollar prices and provide diversification to credit in a stressed environment. Likewise, collateralized mortgage obligations (non-agency RMBS) are attractive relative to IG credit, given a still strong housing market, low LTVs, and robust mortgage loan underwriting. In the asset-backed securities (ABS) space, our caution on the consumer has been consistent with a reduced allocation as bonds pay down, with a current focus on senior bonds that provide structural protection but offer still good yield.

Spreads in both investment-grade and high-yield corporate credit tightened to levels in the fourth quarter not seen since early 2022. Within high yield, these spread levels do not compensate for growth and default risks, but we are mindful that overall yields provide good return potential and some protection to wider spreads. Though our investment-grade exposure is still somewhat meaningful, we made a modest reduction in the fourth quarter, with current holdings focused on defensive, strong cash flow businesses. Tight spreads warrant keeping our spread duration down, but we expect an active new issuer calendar in the first quarter to provide select opportunities.

Within emerging markets, valuations overall appear stretched, but pockets of value exist. There is the prospect for our exposure to improve modestly given expected increased issuance in the first quarter and the expectation for certain sovereigns to pivot to cutting cycles. Various federal and legislative elections in 2024 will provide both risk and opportunity in the sector. Quasi-sovereigns remain interesting in areas where there is fundamental support yet a sizeable spread to the sovereign.

Thanks for your continued support and investing alongside us in Thornburg's fixed income products.

THORNBURG STRATEGIC INCOME FUND

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